Nike Sales Malaysia Sdn Bhd v Jabatan Kastam Diraja Malaysia & Ors

HIGH COURT (KUALA LUMPUR) — ORIGINATING SUMMONS NO R3(1)–25–03 OF 2004
MOHAMAD ARIFF JC
9 APRIL 2009

Customs and Excise — Customs duties — Customs valuation — Declared value of goods imported — Whether royalty cost included — Whether should be part of value to be assessed for customs duties and sales tax — Whether respondents erred when deciding that customs duties and sales tax payable on goods imported by appellant — Whether all relevant parties formed one integrated economic unit — Whether manufacturers and suppliers unrelated third parties — Customs Act 1967 ss 2 & 143A — Customs (Rules of Valuation) Regulations 1999 regs 4 & 5(1)(a)(iv)

This was an appeal brought by Nike Sales Malaysia Sdn Bhd ('Nike Malaysia') against the demand by Jabatan Kastam Diraja Malaysia ('KDRM') for the payment of RM3,292,076.91 as customs duties and sales tax payable by Nike Malaysia for the goods imported by them between January 2000 to February 2003. The audit examination showed royalty cost was not included as part of the paid, or payable, price of the goods. In KDRM's opinion, the royalty cost was a 'transaction condition' for the imported goods for the purpose of customs valuation. Accordingly, KDRM demanded Nike Malaysia for the payment of the abovesaid sum as unpaid duties. Nike Malaysia lodged an appeal to the Director-General of KDRM, which was dismissed. Hence, the present appeal was brought. According to Nike Malaysia, the respondents had erred, in law and in fact, when deciding that the customs duties and sales tax, as assessed, were payable on the goods imported by Nike Malaysia. The main issue in this appeal turns on the central question whether royalty cost should form part of the value of the goods to be assessed for customs duties and sales tax, bearing in mind the relevant provisions in the Customs Act and the Regulations.

Held, allowing the appeal with costs:

(1) It was necessary to consider the economic reality as well as the legal relationship underlying the business transaction flow on the facts of this case. On the facts of this case, all the relevant parties do not form one integrated economic unit. The manufacturers and suppliers were third parties, unrelated to Nike International, Nike USA or Nike Malaysia. There was also the intermediation of Nishho as buying agent and trade financing agent. While it was true that royalty will be payable by Nike

Malaysia to Nike International when the goods are sold and based on net invoiced sales revenues (in accordance with the Intellectual Property Licence and Exclusive Distribution Agreement between Nike Malaysia and Nike International), it was not a condition to be fulfilled for the purpose of the sale of the goods by the manufacturers / suppliers to Nike Malaysia. Indeed, the intellectual property and licensing agreement itself made it clear that non-payment of royalty shall not prevent or impede the sale (see para 31).

(2) The respondents' contention that Nike Malaysia must be taken to purchase the tangible with the intangible, for without the intangible (meaning the trademark and other proprietary rights) the goods did not have value. To obtain the tangible, royalty has to be paid. Therefore, royalty has to be regarded as a condition of sale and accepted as an adjustment item for the purpose of calculating the customs value. This court was of the opinion that if that argument was accepted, the words 'royalties … in respect of the goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to Malaysia', will be rendered devoid of any meaning, since it will be regarded as a condition of sale in all cases, whereas the regulation envisages situations where such payment might not be a condition of sale (see para 32).

(3) The international obligations of Malaysia, in the context of uniform customs valuation interpretation, were reflected in the advisory opinion of the technical committee on customs valuation and the overall context of the WTO valuation agreement. If it is intended that wherever, whenever and however royalty is paid in relation to an export of goods to Malaysia, that royalty must be regarded as an adjustment item for the purpose of calculating 'customs value' and 'transaction value', there will be no need to provide for the legal formula 'as a condition of the sale of goods for export to Malaysia' (see para 60).

(4) Bearing in mind the law, the special facts of this case, and in particular the intricate business transaction flow, the court found that the royalty payable by Nike Malaysia to Nike International cannot properly be taken as a 'condition of the sale of the goods for export to Malaysia' and as an adjustment item under reg 4 read in conjunction with reg 5(1)(a)(iv) Customs (Rules of Valuation) Regulations 1999 (see para 61).

[Bahasa Malaysia summary

Ini adalah rayuan yang dimulakan oleh Nike Sales Malaysia Sdn Bhd ('Nike Malaysia') terhadap tuntutan oleh Jabatan Kastam Diraja Malaysia ('KDRM') untuk bayaran berjumlah RM3,292,076.91 sebagai duti kastam dan cukai jualan yang kena dibayar oleh Nike Malaysia untk barangan yang diimport oleh mereka antara bulan Januari 2000 hingga bulan Februari 2003. Pemeriksaan audit menunjukkan kos royalti tidak dimasukkan sebagai

sebahagian daripada harga barangan yang telah dibayar atau perlu dibayar. Pada pendapat KDRM, kos royalti adalah 'transaction cost' untuk barangan import bagi tujuan taksiran kastam. Oleh demikian, KDRM menuntut Nike Malaysia untuk bayaran jumlah tersebut sebagai duti tidak berbayar. Nike Malaysia telah membuat rayuan kepada Ketua Pengarah KDRM tetapi telah ditolak. Justeru itu, rayuan ini telah dimulakan. Menurut Nike Malaysia, responden-responden tersilap dari segi undang-undang dan fakta apabila memutuskan bahawa duti kastam cukai jualan, sepertimana ditaksirkan, perlu dibayar untuk barangan yang diimport oleh Nike Malaysia. Isu utama dalam rayuan ini menjadi persoalan utama tentang sama ada kos royalti patut membentuk sebahagian daripada nilai barangan yang akan ditaksir untuk duti kastam dan cukai jualan, dengan mengambilkira peruntukan-peruntukan relevan dalam Akta Kastam dan Peraturan-Peraturan.

Diputuskan, membenarkan rayuan dengan kos:

(1) Realiti ekonomi dan juga hubungan sah patut dipertimbangkan berlandaskan aliran transaksi perniagaan berdasarkan fakta kes ini. Berdasarkan fakta kes ini, semua pihak-pihak berkaitan tidak membentuk satu unit ekonomi bersepadu. Pengilang dan pembekal merupakan pihak-pihak ketiga, yang tiada kaitan dengan Nike International, Nike USA atau Nike Malaysia. Terdapat juga perantaraan Nishho sebagai ejen belian dan ejen kewangan dagangan. Jikapun ianya benar bahawa royalti akan dibayar oleh Nike Malaysia kepada Nike International apabila barangan itu dijual dan adalah berdasarkan hasil jualan bersih yang diinvoiskan (menurut perjanjian lesen harta intelek dan pengedaran eksklusif antara Nike Malaysia dan Nike International), ia bukan syarat yang perlu dipenuhi bagi tujuan jualan barangan itu oleh pengilang/pembekal kepada Nike Malaysia. Sememangnya, perjanjian harta intelek dan pelesenan dengan sendirinya telah memperjelaskan bahawa royalti yang tidak dibayar tidak patut menghalang atau menyekat jualan (lihat perenggan 31).

(2) Hujah responden-responden bahawa Nike Malaysia hendaklah dianggap telah membeli yang ketara dengan yang tidak ketara, kerana tanpa yang tidak ketara (bermaksud tanda dagang dan hak-hak ketuanpunyaan lain) barangan itu tidak mempunyai nilai. Untuk memperoleh yang tidak ketara, royalti perlu dibayar. Oleh itu royalti harus dianggap sebagai syarat jualan dan diterima sebagai item ubahsuaian bagi tujuan mengira nilai kastam. Mahkamah ini berpendapat bahawa jika hujah itu diterima maka perkataan-perkataan 'royalties … in respect of the goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to Malaysia', akan dianggap tidak mempunyai apa-apa maksud, oleh kerana ia akan dianggap sebagai satu syarat jualan dalam

semua kes, manakala peraturan membayangkan keadaan di mana bayaran sedemikian tidak semestinya satu syarat jualan (lihat perenggan 32).

(3) Tanggungjawab antarabangsa Malaysia, dalam konteks pentafsiran penilaian kastam seragam dinyatakan dalam jawatankuasa teknikal penasihat pendapat tentang penilaian kastam dan konteks keseluruhan perjanjian penilaian WTO. Jika ianya merupakan niat bahawa di mana, bila-bila masa dan apa carapun royalti dibayar berkaitan barangan yang dieksportkan ke Malaysia, maka royalti tersebut perlu dianggap sebagai item ubahsuaian bagi tujuan mengira 'customs value' dan 'transaction value', tidak perlu untuk memperuntukkan rumusan perundangan ' as a condition of the sale of goods to Malaysia (lihat perenggan 60).

(4) Dengan mengambilkira undang-undang, fakta penting kes ini, dan khususnya aliran transaksi perniagaan yang kompleks, mahkamah ini mendapati bahawa royalti yang perlu dibayar oleh Nike Malaysia kepada Nike International tidak boleh dianggap sebagai 'condition of the sale of the goods for export to Malaysia' dan sebagai ubahsuaian item di bawah peraturan 4 dibaca bersama peraturan 5(1)(a)(iv) Peraturan-Peraturan Kastam (Kaedah Penilaian) 1999 (lihat perenggan 61).]

Notes

For a case on customs duties, see 6 *Mallal's Digest* (4th Ed, 2010 Reissue) para 37.

Cases referred to

Adidas New Zealand Ltd v Control of Customs (Northern Region) [1999] 1 NZLR 558 (refd)

Avon Cosmetics Ltd v Collector of Customs [1999] NZAR 345 (refd)

Chief Executive of NZ Customs Service v Nike New Zealand Ltd [2004] 1 NZLR 238, CA (refd)

Estee Lauder Pty Ltd v Comptroller-General of Customs and Anor [1991] Australia Federal Court Lexis 3; (1991) FCA 284, FC (refd)

Mattel Canada Inc (appellant) v Her Majesty The Queen (respondent) and Reebok Canada Inc (intervener)and Her majesty The Queen (appellant) v Mattel Canada (respondent) and Reebok Canada Inc (intervener) [2001] NR Lexis 128, SC (folld)

Legislation referred to

Customs Act 1967 ss 2, 142(35B), 143A
Customs Act [CAN] s 48, 48(5)(a)(iv)
Customs (Amendment) Act 2007 s 10(3)
Customs (Appeal Tribunal) Regulations 2007
Customs (Rules of Valuation) Regulations 1999 regs 4, 5, 5(1)(a)(iv)
Interpretation Acts 1948 and 1967 s 17A

A Tariff Act 1988 [NZ] ss 2, 5, Second Schedule

K Maniam (Skrine) for the appellant.
Saiful Edris bin Zainuddin (Senior Federal Counsel, Legal Department, Royal Malaysian Customs Head Office) for the respondent.

B

Mohamad Ariff JC:

C **[1]** This is an appeal brought by Nike Sales Malaysia Sdn Bhd ('Nike Malaysia') under s 143A of the Customs Act 1967 against the demand by Kastam Diraja Malaysia for the payment of RM3,292,076.91 as customs duties and sales tax payable by Nike Malaysia under reg 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999 ('the Regulations'). According to Nike Malaysia, the respondents (Jabatan Kastam Diraja Malaysia D ('KDRM'), Ketua Pengarah Kastam('KPK') and the Government of Malaysia erred, in law and in fact, when deciding that the customs duties and sales tax, as assessed, were payable on the goods imported by Nike Malaysia.

BACKGROUND FACTS

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[2] The Post-Import Audit Division of the KDRM, Wilayah Persekutuan, Kuala Lumpur, carried out an audit on the declared value of goods imported by Nike Malaysia between January 2000 to February 2003. The audit F examination showed royalty cost was not included as part of the paid, or payable, price of the goods. In KDRM's opinion, the royalty cost was a 'transaction condition' for the imported goods for the purpose of customs valuation. A letter of demand dated 15 August 2003 was therefore issued by KDRM to Nike Malaysia demanding the payment of the abovesaid G RM3,292,076.91 as unpaid duties. This figure has been corrected and reduced subsequently to RM2,675,344.19.

[3] Nike Malaysia lodged an appeal to the Director-General of KDRM, which was dismissed. Hence, the present appeal is brought under s 143A of the H Customs Act by virtue of a transitional provision in s 10(3)of the Customs (Amendment) Act 2007/Act A1282. Section 10(3) reads:

> Any appeal under section 143A of the principal Act to the Court made before the appointed date and is pending on such date shall, after the appointed date, be continued as if the principal Act had not been amended by this Act.

I

[4] As is well known, the Nike brand is associated with footwear, apparel, sports equipment and accessories. On the facts of this appeal, Nike Malaysia, the Malaysian company, imports and sells these items.

[5] The main issue in this appeal turns on the central question whether royalty cost should form part of the value of the goods to be assessed for customs duties and sales tax, bearing in mind the relevant provisions in the Customs Act and the Regulations. The issue involves a question of interpretation of these provisions, and, in this respect, it becomes necessary as well to consider the position indicated by the valuation principles adopted by the World Trade Organisation ('WTO'), of which Malaysia is a signatory. It is necessary to mention, at the outset, that there appears to be divergent views on the matter in some parts of the Commonwealth, notably in Canada and New Zealand. In the course of submission, this court was alerted to a recent decision of the Customs Appeals Tribunal in *Colgate-Palmolive Marketing (M) Sdn Bhd v Ketua Pengarah Kastam* (Appeal No TRK(J) 2 of 2008). However, I was informed that to date there has not been any ruling by the High Court on this matter. The *Colgate-Palmolive* dispute was brought before the Customs Appeals Tribunal since the decision impugned was made after the Customs (Appeal Tribunal) Regulations 2007 came into force; the decision by the Director-General here, however, was given on 4 December 2003, a date before the Customs (Appeal Tribunal) Regulations 2007 came into force. This is the reason why this court is hearing this appeal and not the Tribunal. Nevertheless, the *Colgate-Palmolive* decision must be given due recognition and respect, and this I have done.

THE VIEWPOINT OF KDRM ON THE LAW AND THE APPLICABLE FACTS

[6] KDRM's position is based essentially on the proper meaning to be ascribed to the term 'customs value'. In this regard, s 2 of the Customs Act becomes material, and it reads:

> 'value' in relation to imported goods means customs value as determined under section 142 (35B).

[7] Section 142(35B) of the Act specifies that the Minister may make Regulations to determine the customs value of imported goods, and under the section the Customs (Rules of Valuation) Regulations 1999 are made. Regulation 4 of the Regulations states:

> (1) The customs value of imported goods shall be their transaction value, that is, the price paid or payable for the goods when sold for export to Malaysia, adjusted in accordance with Regulation 5.

[8] Regulation 5(1)(a)(iv) then provides the adjustment elements in determining the transaction value under reg 4 of the Regulations, providing as follows:

(1) In determining the transaction value of imported goods under Regulation 4, the price paid or payable for the goods shall be adjusted:

(a) by adding thereto amounts, where such amount is not already included in the price paid or payable for the goods, determined on the basis of sufficient information, equal to:

(b) royalties and licence fees, including payments for patents, trademarks and copyrights in respect of the goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to Malaysia, exclusive of charges for the rights to reproduce the goods in Malaysia.

WHETHER ROYALTY IS AN ADJUSTMENT ELEMENT AND A CONDITION OF SALE

[9] Ignoring for the moment the intricate legal wordings applicable, the dispute between the parties is reduced to this proposition: Nike Malaysia says the royalty should not be part of the value to be assessed for customs duties and sales tax because it is not a condition of sale by the exporter, whereas KDRM says it has to be included in the customs value, although the declared value states otherwise, since it must be taken as an adjustment item because the royalty is, directly or indirectly, a condition of the sale of the goods for export to Malaysia. As put succinctly by learned senior federal counsel, Encik Saiful Idris, could Nike Malaysia have purchased the tangible goods without the intangible (the royalty payment), or if Nike International Limited were not paid the royalty, could the sale be stopped? If the import of the goods could be stopped if royalty were not paid, on this argument, the royalty payment would be indirectly a condition of the sale, and, therefore, would be a valid adjustment item under reg 5(1)(a)(iv) of the Regulations.

[10] Encik K Maniam, counsel for Nike Malaysia, on the other hand, stressed on the requirement between the immediate parties that royalty was based on sales to local purchasers, and that royalty was payable to the brand owner, not the exporter. The brand owner and the exporter on the facts of this case were different legal entities; the brand owner being Nike International Limited ('Nike International'), while the exporters were unrelated third party manufacturers through the intermediation of Nike Malaysia's appointed buying agents, Nike Inc ('Nike USA') and Nissho Iwai America Corporation ('Nissho'). According to the business transaction arrangement between the parties, Nike Malaysia placed purchase orders with Nike USA, who would then pass the purchase orders to unrelated third party manufacturers, who would then export the goods to Nike Malaysia and invoice Nike Malaysia accordingly through the intermediation of Nissho. Payment for the goods would be made to the manufacturers through Nissho. In this arrangement, no royalty was payable to Nike USA, which acted as essentially the buying agent for the purposes of locating the factories to manufacture the goods, negotiating the

prices and forwarding the purchase orders. Nissho acted as the trade financing entity and purchasing agent, appointed by Nike Malaysia. It was through Nissho that the invoices were issued and payments made for the goods, plus commission and interest. According to Nike Malaysia's argument, royalty on the goods was payable to Nike International on the basis of invoiced sales to customers; it was not a condition of sale that the royalty must be paid to Nike International before the goods could be imported. Nike International was not an immediate entity to this business transaction flow ending with the payment for the imported goods.

THE BUSINESS TRANSACTION FLOW

[11] The business transaction flow is described by Nike Malaysia as follows:

(a) Nike Malaysia determines what goods and quantities of goods it wishes to order and purchase directly from unrelated manufacturers through its agents;

(b) Nike USA as its buying agent will negotiate the terms with non-Malaysian suppliers/manufacturers and forward the purchase orders placed by Nike Malaysia;

(c) Nike Malaysia will then receive orders confirmation that orders have been placed with the supplier/manufacturer;

(d) Nike Malaysia will notify Nissho, as an independent buying agent, of the purchase orders to arrange financing and contract documentation on behalf of Nike Malaysia;

(e) Nissho will invoice Nike Malaysia on a per shipment basis, including the invoice amount, costs and commission due to Nissho for its services as purchasing agent;

(f) Where products are manufactured in Malaysia, Nike Malaysia deals directly with the local manufacturers and does not use Nike USA or Nissho as part of the transaction.

[12] Three inter-related agreements underpin this transaction flow: (1) a purchase commission agreement, (2) a buying agency and logistics

[13] Three inter-related agreements underpin this transaction flow: (1) a purchase commission agreement, (2) a buying agency and logistics services agreement, and (3) an intellectual property licence and exclusive distribution agreement.

THE PURCHASE COMMISSION AGREEMENT

[14] It suffices to refer to cl 2.1.1 of the purchase commission agreement for our present purposes:

> NIKE [Nike Inc] shall receive purchase orders from Participating Company [Nike Malaysia] for products and shall place such orders with its selected foreign manufacturers. NIKE shall order such products at favourable prices in accordance with the requirements of the Participating Company with respect to type, quantity, delivery, deadlines, financing and insurance. NIKE shall deliver such products, or arrange for their delivery, to such ports as the Parties may from time to time determine. NIKE shall act in its own name, for the account of the Participating Company, but shall have authority to represent and bind Participating Company vis-a-vis foreign manufacturers.

BUYING AGENCY AND LOGISTICS SERVICES AGREEMENT

[15] As for the buying agency and logistics services agreement, the agreement is between Nike Malaysia and Nissho, for Nissho to provide:

> 3.1 *Buying Agency Services*, including the purchase of Goods from Suppliers on behalf of NIKE on a disclosed principal basis;
>
> 3.2 *Trade Financing*, including the payment of funds on behalf of NIKE (which are treated as reimbursable costs.) to L/C Issuers, suppliers, transportation companies, third party logistics providers, Insurers, custom brokers, and government authorities (e.g. customs authorities) as directed by NIKE;
>
> 3.3 *L/C and Payment Process Management*, including the application for, amendment of, payment under, and tracking of L/C's or open account purchases on behalf of NIKE on a disclosed principal basis in accordance with NIKE's instructions; and
>
> 3.4 *Recordkeeping and Documentation Services*, including but not limited to generation, communication and consolidation of purchase orders and invoices (including electronic file generation and communication), review and tracking of shipping documentation, compliance with Customs and other Government agency requirements, and warehousing of data relating to the Services. (Cl 3)

INTELLECTUAL PROPERTY LICENCE AND EXCLUSIVE DISTRIBUTION AGREEMENT

[16] This third agreement is entered into between Nike Malaysia and Nike International as the licensor. Under the agreement, Nike Malaysia is granted, inter alia:

> … a non-transferable and non-exclusive licence to manufacture or subcontract for the manufacture of licensed goods using the Trademarks and Other Proprietary Rights …
>
> … a non-transferable and exclusive licence (i) to sell licensed goods in the Licensed Territory and (ii) to use the Trademarks and Other Proprietary Rights in the Licensed Territory in connection with the advertising, marketing and sale of licensed goods … (Cl 2)

[17] In return for the licence to manufacture or subcontract for the manufacture of the licensed goods, and the licence to sell the licensed goods, the licensee, Nike Malaysia, has to pay Nike International royalty of 6% of the net invoiced sales revenue of all licensed goods sold in Malaysia. This is covered in cl 10 of the agreement:

> 10.1 Licensee agrees to pay licensor a royalty of 6% of the net invoiced sales revenues of all licensed goods sold in the licensed territory.

[18] It is pertinent, for purposes of appreciating the business transaction flow, to highlight the provision of cl 13.1 in the agreement which reads:

> Licensee shall have the right to subcontract for the manufacture of licensed goods and shall be free to choose the suppliers with whom it so subcontracts. The parties agree that licensor shall impose no restrictions on licensee's choice of such suppliers. The parties further agree that in the event of non-payment of the royalty provided under section 10, licensor shall not prevent or impede such supplier from selling to licensee licensed goods manufactured pursuant to binding orders accepted by such supplier prior to such supplier's receipt of notice of termination of this agreement; provided, however, that this provision shall not restrict licensor from asserting against licensee any claims that licensor may have against licensee under this agreement or otherwise.

[19] With reference to this provision in the agreement, counsel for Nike Malaysia argued that the payment of royalty was not a condition of sale of the goods from third-party suppliers or manufacturers to Nike Malaysia.

THE BASIC RELATIONSHIP BETWEEN THE PARTIES

[20] It is important to be clear on the basic relationship between the parties in the business transaction flow. Nike USA (Nike Inc) is the ultimate holding company of Nike International and Nike Malaysia. Nissho is an independent, unrelated third-party that acts as a buying and trade financing agent. The manufacturers/suppliers who export the goods to Nike Malaysia, through the intermediation of Nike USA and Nissho, are unrelated, independent third parties. Nike Malaysia is under an obligation to pay royalty, based on net invoiced sales, to Nike International. So, what exactly is the customs value of the imported goods? Is it to be the transaction value with an adjustment item representing royalty payable on the goods, or merely the transaction value without the element of royalty?

[21] It is, however, clear that if royalty has to be taken as an adjustment item, and assuming payment of royalty is a condition of sale of the imported goods, such payment has to be an indirect condition of sale.

A MALAYSIA'S WTO OBLIGATIONS UNDER THE WTO VALUATION AGREEMENT

[22] The Malaysian Customs Valuation Rules reflect and incorporate the principles elaborated in the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994, in particular arts 1 and 8 of this multilateral treaty, of which Malaysia is a signatory. The preamble to the agreement is illustrative, and sets out the approach to be taken by member states:

> …
>
> *Recognising* the need for a fair, uniform and neutral system for the valuation of goods for customs purposes that precludes the use of arbitrary or fictitious customs values;
>
> *Recognising* that the basis for valuation of goods for customs purposes should, to the greatest extent possible, is the transaction value of the goods being valued;
>
> *Recognising* that customs value should be based on simple and equitable criteria consistent with commercial practices and that valuation procedures should be of general application without distinction between sources of supply; …

[23] The preamble also made clear the desire of member states 'to elaborate rules for their application in order to provide greater uniformity and certainty in their implementation'.

[24] I quote art 1:

> 1 The customs value of imported goods shall be the transaction value, that is the price actually paid or payable for the goods when sold for export to the country of importation adjusted in accordance with the provisions of Article 8 …

[25] Article 8 then provides in its material parts, for our present purposes:

> (1) In determining the customs value under the provisions of Article 1, there shall be added to the price actually paid or payable for the goods:
>
> c) royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable …

[26] 'Interpretative Notes' are annexed as Annex 1 to the agreement, and the 'Note to art 8' include the following principles:

> (1) The royalties and licence fees referred to in paragraph 1 (c) of Article 8 may

include, among other things, payments in respect to patents, trademarks and copyrights. However, the charges for the right to reproduce the imported goods in the country of importation shall not be added to the price actually paid or payable for the imported goods in determining the customs value.

(2) Payments made by the buyer for the right to distribute or resell the imported goods shall not be added to the price actually paid or payable for the imported goods if such payments are not a condition of the sale for export to the country of importation of the imported goods.

[27] These laudable principles of international economic law have been expressly incorporated as part of our domestic law through the Customs (Rules of Valuation) Regulations 1999. That being the case, the interpretation of regs 4 and regs 5 of the Customs (Rules of Valuation) Regulations 1999 cannot be an isolated, domestic exercise. In this regard, due emphasis has to be given to the advisory opinions of the technical committee on customs valuation ('TCCV') established under the agreement. The TCCV has, as one of its responsibilities, the duty 'to examine specific technical problems arising in the day-to-day administration of the customs valuation system of members and to give advisory opinions on appropriate solutions based upon the facts presented' (see para 2, Annex II to the agreement).

ADVISORY OPINIONS OF TCCV

[28] Through the industry of counsel, my attention was drawn to 4 advisory opinions given by the TCCV in relation to 'Royalties and Licence Fees Under Art 8.1 (c) of the agreement', namely advisory opinion 4.2, advisory opinion 4.8, advisory opinion 4.11, and advisory opinion 4.13. Both counsel for the applicant and the respondent agreed that these TCCV's opinions, though not strictly binding on the domestic courts in Malaysia, are nevertheless of persuasive value. Counsel for the applicant was candid enough to acknowledge that three out of the four advisory opinions were in his favour, but one was not (advisory opinion 4.11).

[29] I feel it necessary to add in this connection that the Customs Appeal Tribunal in the *Colgate-Palmolive* decision has admirably analysed in great detail these four advisory opinions, and like the Customs Appeal Tribunal, I believe it is important to understand and appreciate these opinions, bearing in mind the larger international obligations in this regard of Malaysia. I therefore reproduce in full the four advisory opinions below.

Advisory Opinion 4.11

(a) Sportswear manufacturer M and importer I are both related to parent company C which owns the rights of a trademark which is affixed to the sportswear. In the sales contract between M and I there is no requirement

for the payment of royalty. I, however, in accordance with a separate agreement with C, is obliged to pay a royalty to C in order to obtain the right to use the trademark which is affixed to sportswear I purchased from M. Is the royalty payment the condition of sale of, and related to, the imported sportswear?

(b) The Technical Committee on Customs Valuation expressed the following view.

The sales contract between M and I covering trademarked goods does not contain specific conditions with respect to royalty payments. However, the payment in question is a condition of sale as I is obliged to pay the royalty to the parent company as a result of buying the goods. I does not have the right to use the trademark without payment of the royalty. The fact that there is no written contract with the patent company does not detract from the obligation of I to make a payment as required by the parent company. For reasons stated above, payments for the right to use the trademark are related to the goods being valued and the amount of the payments should be added to the price actually paid or payable.

Advisory opinion 4.13

(a) Importer I purchased a sports bags from foreign manufacturer M, as well as from other suppliers. Importer I, manufacturer M and other suppliers are all unrelated.

Importer I, on the other hand, is related to company C which holds the right of a trademark. Under the terms of a contract between I and C, C transfers the right to use the trademark to I against a royalty payment.

Importer I furnishes manufacturer M and other suppliers with labels bearing the trademark which are affixed to the sports bags before the importation.

Is the royalty related to the goods being valued? Does a payment from I to C form part of the condition of sale between M and I and I and other suppliers?

(b) The Technical Committee on Customs Valuation expressed the following view.

Although the importer is required to pay a royalty to obtain the right to use the trademark, this results from a separate agreement unrelated to the sale for export of the goods to the country of importation. The imported goods are purchased from various suppliers under different contracts and the payment of a royalty is not a condition of the sale of these goods. The buyer does not have to pay the royalty in order to purchase the goods. Therefore, it should not be added to the price actually paid or payable as an adjustment under art 8.1(c).

Whether the supply of labels evidencing the trademark would qualify as dutiable under the provisions of art 8 8.1(B) is a separate consideration.

Advisory opinion 4.8

(a) Importer I enters into a licence/royalty agreement with licence holder L established in country X under which I agrees to pay L a fixed sum of royalty for each pair of shoes bearing the trademark of L imported into the country or importation. Licence holder L provides art and design work relating to the trademark. Importer I concludes another agreement with manufacturer M of country X for the purchase of shoes bearing the trademark of L affixed to the shoes by M, supplying M with the art and design work provided by L. Manufacturer M is not licensed by L. This sales agreement does not contain any reference to the payment of royalty. The manufacturer the importer and the licensor are all unrelated.

(b) The Technical Committee on Customs Valuation expressed the following view.

The importer is required to pay a royalty to obtain the right to use the trademark. This obligation results from a separate agreement unrelated to the sale for export of the goods to the country of importation. Goods are purchase from a supplier under another contract and payment of royalty is not a condition of sale of these goods. Therefore, the royalty payment in this case is not to be added to the price actually paid or payable.

Whether the supply of the art and design work relating to the trademark would qualify as dutiable under the provisions of art 8.1(b) is a separate consideration.

Advisory opinion 4.2

(a) Phonograph records of a musical performance are purchased by an importer from a manufacturer. Under the laws of the country of importation when he resells the records the importer is required to pay a royalty of 3% of the sale price to a third party, the author of the musical composition, who holds a copyright. No part of the royalty accrues directly or indirectly to the manufacturer, nor is it paid as an obligation under the contract of sale. Should the royalty be added to the price actually paid or payable?

(b) The Technical Committee of Customs Valuation expressed the following view.

The royalty should not be added to the price actually paid or payable in determining the customs value; payment of the royalty is not a condition of the sale for export of the imported goods but arises from a legal obligation on this importer to pay the copyright holder when the records are sold in the importing country.

[30] Advisory opinions 4.11 and 4.13 provide useful pointers in what should be the proper interpretation of regs 4 and 5 of the Regulations. In both advisory opinions, the question of royalty is not directly addressed in the contract of sale. It seems to me to determine whether the payment of royalty is, or is not, the condition of sale, the relationship between the parties becomes important. In advisory opinion 4.11, both the manufacturer and the importer are related parties. In advisory opinion 4.13 the importer, the manufacturer and the suppliers are not related parties, although the importer is related to the entity to whom royalty is payable. Similarly, in advisory opinion 4.11 the importer is related to the trademark owner. The overriding test is whether the buyer or importer has, or has not, the obligation to pay the royalty in order to purchase or import the goods. If the obligation arises from a separate agreement that is unrelated to the sale or importation of the goods, it cannot be regarded as a condition of the sale of the goods.

APPLICATION OF THE PRINCIPLES TO THE FACTS OF THIS CASE

[31] In my view, it is necessary to consider the economic reality as well as the legal relationship underlying the business transaction flow on the facts of this case. On the facts of this case, all the relevant parties do not form one integrated economic unit. The manufacturers and suppliers are third parties, unrelated to Nike International, Nike USA or Nike Malaysia. There is also the intermediation of Nishho as buying agent and trade financing agent. While it is true that royalty will be payable by Nike Malaysia to Nike International when the goods are sold and based on net invoiced sales revenues (in accordance with the Intellectual Property Licence and Exclusive Distribution Agreement between Nike Malaysia and Nike International), it is not a condition to be fulfilled for the purpose of the sale of the goods by the manufacturers/suppliers to Nike Malaysia. Indeed, the intellectual property and licensing agreement itself makes it clear that non-payment of royalty shall not prevent or impede the sale.

[32] The question was posed by counsel for the respondents, in the course of submission, that Nike Malaysia must be taken to purchase the tangible with the intangible, for without the intangible (meaning the trademark and other proprietary rights) the goods do not have value. To obtain the tangible, royalty has to be paid. Therefore, royalty has to be regarded as a condition of sale and accepted as an adjustment item for the purposes of calculating the customs value. With due respect, if this argument is accepted, the words 'royalties … in respect of the goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to Malaysia', will be rendered devoid of any meaning, since it will be regarded as a condition of sale in all cases, whereas the regulation envisages situations where such payment might not be a condition of sale.

[33] On the other hand, Mr Maniam, counsel for the applicant/plaintiff argued that the relevant test should be based on the existence of economic and legal interdependence between the parties.

COMMONWEALTH DECISIONS

[34] I now turn to the several decisions delivered by courts in the Commonwealth on this question, as advanced in submission, to support the respective positions of the parties here. Described by counsel for the plaintiff as the centre-piece of the argument in this case, the choice is between the reasoning adopted by the courts in Canada as against the courts in New Zealand. Two leading cases were submitted before as persuasive authorities: *Mattel Canada Inc (appellant) v Her Majesty The Queen (respondent) and Reebok Canada Inc (intervener)and Her Majesty The Queen (appellant) v Mattel Canada (respondent) and Reebok Canada Inc (intervener)* [2001] NR Lexis 128 ('*Mattel Canada*') and *Chief Executive of NZ Customs Service v Nike New Zealand Ltd* [2004] 1 NZLR 238('*Nike New Zealand*').

THE *MATTEL CANADA* CASE

[35] The facts in *Mattel Canada* are illustrative and bear similarities with the facts in this application. I summarise hereafter the basic facts distilled from the Supreme Court of Canada judgment.

[36] Mattel Canada Inc ('Mattel Canada') is a wholly-owned subsidiary of Mattel Holdings Ltd ('Mattel Holdings'), which in turn is a whollyowned subsidiary of Mattel Inc ('Mattel US'). Mattel US owns Mattel Trading Co Ltd ('Mattel Trading') and Mattel Trading Vendor Operations Limited ('Mattel Vendor'). Mattel Trading and Mattel Vendor are both located in Hong Kong.

[37] Mattel Canada orders goods through a computer system owned by Mattel US, but the goods are manufactured in Hong Kong by third parties.

[38] Once the goods are manufactured, the manufacturers will invoice Mattel Trading which will then invoice Mattel US, which will in turn invoice Mattel Canada.

[39] Mattel Canada pays royalties on the trademarked goods to 'Licensor X' based on a percentage of net invoiced billings for goods sold to Canadian customers. The trademark licensor was referred to throughout the proceedings as licensor X because of what appeared to be a court-approved confidentiality arrangement.

[40] The agreement under which Mattel US sold the goods to Mattel Canada did not make the sale of goods conditional on the royalty payments being made to Licensor X. The relevant statutory provision, for our purposes, is s 48 of the Canadian Customs Act, which reads in its material parts:

> 48
>
> (1) Subject to subsection (6), the value for duty of goods sold is the transaction value of the goods if the goods are sold for export to Canada and the price paid or payable for the goods can be determined …
>
> (4) The transaction value of goods shall be determined by ascertaining the price paid or payable for the goods when the goods are sold for export to Canada and adjusting the price paid and payable in accordance with subsection (5).
>
> (5) The price paid or payable in the sale of goods for export to Canada shall be adjusted
>
> (a) by adding thereto amount, to the extent that each such amount is not already included in the price paid or payable, equal to …
>
> (iv) royalties and licence fees, including payments for patents, trademarks and copyrights, in respect of the goods that the purchaser of the goods must pay, directly or indirectly, as a condition of the sale of the goods for export to Canada, exclusive of charges for the right to reproduce the goods in Canada …

[41] As can be seen from the above excerpt of s 48 of the Canadian Customs Act, there are very close similarities between s 48 and the Malaysian regs 4 and 5. Indeed, the Malaysian reg 5(1)(a)(iv) is almost in pari materia with s 48(5)(a)(iv) of the Canadian Customs Act. Only the words 'determined on the basis of sufficient information' are missing from the Canadian s 48(5)(a)(iv). In this regard, the decision and views expressed by the Supreme Court of Canada should, in my mind, be regarded as very persuasive.

[42] The Canadian International Trade Tribunal decided in favour of Mattel Canada by holding that the royalty payments should not be included as an adjustment amount. This decision was upheld on appeal to the Canadian Federal Court of Appeal, which also decided in favour of Mattel Canada, although on slightly different reasons. The Canadian Government appealed to the Supreme Court of Canada which also held in Mattel Canada's favour.

[43] I quote the relevant finding of the Supreme Court:

> In summary, s 48(5)(a)(iv) requires that royalties and licence fees be paid 'as a condition of the sale of the goods for export to Canada'. The words incorporate traditional concepts found in sale of goods legislation and the common law of contract. Unless the vendor is entitled to refuse to sell the goods to the purchaser or repudiate the contract of sale where the purchaser fails to pay royalties or licence fees,

s 48(5)(a)(iv) is inapplicable. The royalties that Mattel Canada paid to Licensor X are not royalties within the meaning of s 48(5)(a)(iv) of the Customs Act.

I would therefore dismiss the Deputy Minister's cross-appeal. (at para 68 of the reported judgment).

[44] No doubt the Canadian Supreme Court came to this view after referring to the accepted legal meaning of 'condition of sale', and in this the court seemed to have been persuaded by Professor Atiyah's textbook, *The Sale of Goods*, where the learned author states 'in its usual meaning a condition is a term which, without being a fundamental obligation imposed by the contract, is still of such vital importance that it goes to the root of the transaction' and 'the importance of a condition in contracts for the sale of goods is that its breach, if committed by the seller, will give the buyer the right to reject the goods completely and to decline to pay the price, or if he has already paid for it, to recover it'.

[45] For the Government of Canada, it was argued that the economic realities of the transaction should be considered. The Deputy Minister had argued that if Mattel Canada failed to pay royalties to Licensor X, it would effectively cease to be permitted to import goods bearing its trademark. The Supreme Court dismissed what it described as 'a species of economic realities test', and the tests of 'true connection' and 'effective control' as well as the 'practical' or 'logical' test.

[46] On this, the Supreme Court of Canada said:

Rather than argue that the royalties were paid as a condition of sale in the manner envisaged by common law and sales of goods law, the Deputy Minister advanced a species of economic realities test. The Deputy Minister argued that if Mattel Canada failed to pay royalties to licensor X, it would 'effectively cease' to be permitted to import goods bearing its trademark. The Deputy Minister used similar language like 'true connection', 'effective control', 'practical' and 'logical' to describe the manner in which the royalties that Mattel Canada paid to licensor X could constitute 'a condition of the sale of the goods for export to Canada' as between Mattel US and Mattel Canada. The words 'condition of sale' as they appear in s 48(5)(a)(iv) are clear and unambiguous. This court has repeatedly held that where clear and unambiguous statutory provisions can be applied directly to the facts, it is not necessary to resort to an analysis of the economic realities of a transaction … (paras 63 and 64 of the judgment).

[47] The Supreme Court of Canada, in applying the law to the facts, also said:

> Had Parliament intended for all royalties and licence fees to be dutiable, it would not have stated it is only those that are paid 'directly or indirectly', as a condition of the sale of the goods for export to Canada' in accordance with s 48(5)(a)(iv) (the provision is in pari materia with the Malaysian regulation) that are dutiable.
>
> The royalties …were not paid as a condition of sale. If Mattel Canada refused to pay royalties to Licensor X, Mattel USA could not refuse to sell the licensed goods to Mattel Canada or repudiate the contract of sale. The sale contract and the royalties contract were separate agreements between different parties ….

THE *NIKE NEW ZEALAND* CASE

[48] By way of contrast, a different approach was adopted by the courts in New Zealand, as can be seen in the *Nike New Zealand* case. This is a New Zealand Court of Appeal majority decision, with a strong dissenting opinion by one judge.

[49] The relevant provisions are ss 2 and 5 of the Tariff Act 1988, and the Second Schedule to the Act. The immediately relevant provision is cl 3(1)(a)(iv) of the Second Schedule which reads:

> (a) by adding thereto amounts, to the extent that each such amount is not otherwise included in the price paid or payable for the goods and is determined on the basis of sufficient information, equal to —
>
> (i) commissions and brokerage in respect of goods incurred by the buyer, other than fees paid or payable by the buyer to the buyer's agent for the service of representing the buyer overseas in respect of the purchase of the goods; and
>
> (iv) royalties and licence fees, including payments for patents, trademarks, and copyrights in respect of imported goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to New Zealand, exclusive of charges for the right to reproduce the imported goods in New Zealand.

[50] As far as the factual matrix is concerned, the facts in the *Nike New Zealand* case are almost on all fours with the facts in this current application; that it is so is understandable because the same party is involved, namely Nike. The business transaction flow in *Nike New Zealand* also includes the presence and participation of NIAC, identified in this current appeal as Nissho.

[51] The New Zealand Court of Appeal in fact referred to the *Mattel Canada* case, but preferred to depart from its reasoning, and in fact characterised that decision, inter alia, as 'inappropriately technical' and 'had effectively introduced the words 'of the contract of' before 'the sale of the goods'...' (at p 252 of the report). The New Zealand Court said:

> Although there is a unanimous single judgment of a court whose views are held in high regard, we have to say that we find the approach taken inappropriately narrow in the context of the interpretation of an international agreement. That is not to say that we would disagree with the result on the particular facts which are readily distinguishable from the present case and from *Adidas* and *Avon* (at p 252 of the report).

[52] The Court of Appeal New Zealand instead held (in part on relying on the reasoning of the Canadian Federal court of appeal in the *Mattel* case, which reasoning was not followed by the Supreme Court of Canada):

> That view was not accepted by the Supreme Court … but, with respect, we find it convincing. It seems the best that for a royalty to come within some sub para (iv) there must be a combination of two features. First, the royalty must be payable to the manufacturer or to another person as a consequence of the export of the goods to New Zealand and, secondly, the party to whom the royalty is payable must have a control of the situation going beyond the ordinary rights of a licensor of intellectual property and giving it the ability to determine whether the export to New Zealand can or cannot occur. An ordinary licensor, unrelated to the licensee, may be able to take steps to prevent future importations if royalties are not paid in respect of a particular importation of licensed products, but it has no control over and importation prior to any default. In contrast, where royalties are payable to a licensor which is a member of the same corporate group as the licensee — and particularly where the buying is in practice conducted through another member of the corporate group — the situation is throughout under the parent company's control exercisable on the part of the licensor … In the present case, the goods bearing the licensor's trademarks and utilising its other intellectual property were able to be exported to New Zealand only because of the existence of the licence agreement which required the payment of royalty (at p 254 of the report).

[53] In coming to this decision, the New Zealand Court of Appeal referred to and approved two earlier decisions of the New Zealand courts in *Adidas New Zealand Ltd v Control of Customs (Northern Region)* [1999] 1 NZLR 558 and *Avon Cosmetics Ltd v Collector of Customs* [1999] NZAR 345.

[54] To my mind, the test adopted by the New Zealand Court may be difficult to apply in practice. In *Nike New Zealand* case, the Court of Appeal stated that the 'condition of sale' requirement is satisfied when there is a combination of two features, namely:

(a) The royalty is payable to the manufacturer or to another person as a consequence of the export, and

(b) The party to whom the royalty is payable must have control beyond the rights of an ordinary licensor of intellectual property and giving it the ability to determine whether the export to New Zealand can or cannot occur.

[55] It might be difficult to ascertain in any fact-situation what is connoted by 'control beyond the rights of an ordinary licensor'.

[56] Mention must also be made of the Federal Court of Australia case in *Estee Lauder Pty Ltd v Comptroller-General of Customs and Anor* [1991] Australia Federal Court Lexis 3, where the 'single transaction' test was employed, the question being whether the royalty payable will be part of the price of the goods on the basis that the licence agreement is so closely connected with the contract of sale that they form one single transaction.

[57] On the facts of our case, I do not think the intricate business transaction flow here can lead to the conclusion that the licence agreement and the contract of sale comprise one single transaction. The transaction mechanism adopted by the parties is simply too complex, whether in form or in substance, for this conclusion to be made.

[58] Having considered the principles as interpreted by the TCCV in the advisory opinions, I am of the opinion that the views expressed by the Supreme Court of Canada in the *Mattel Canada* case represent the better position, as opposed to the New Zealand Court of Appeal decision in the *Nike New Zealand* case.

CONCLUSION

[59] This application involves, in essence, an issue of statutory interpretation, which is obviously a question of law. As such, the meaning to be ascribed to the term 'condition of sale' must be approached as a legal question. The accepted principles of statutory interpretation do not allow reference to be made to the tests of 'economic realities' or 'economic control' without taking into account, first and foremost, the words used in the statutory provision. Such an approach conforms to s 17A of the Interpretation Acts 1948 and 1967 which enjoins a court in terms:

> In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.

[60] The international obligations of Malaysia, in the context of uniform customs valuation interpretation, are reflected in the advisory opinion of the TCCV and the overall context of the WTO valuation agreement. If it is intended that wherever, whenever and however royalty is paid in relation to an export of goods to Malaysia, that royalty must be regarded as an adjustment

item for the purposes of calculating 'customs value' and 'transaction value', there will be no need to provide for the legal formula 'as a condition of the sale of goods for export to Malaysia'.

[61] Bearing in mind the law, the special facts of this case, and in particular the intricate business transaction flow, I find that the royalty payable by Nike Malaysia to Nike International cannot properly be taken as a 'condition of the sale of the goods for export to Malaysia' and as an adjustment item under reg 4 read in conjunction with reg 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999.

[62] On the basis of the above reasoning, and the interpretation of regs 4 and 5 of the Customs (Rules of Valuation) Regulations 1999 adopted by this court, this appeal is allowed as prayed, with costs to be taxed.

Appeal allowed with costs.

Reported by Ashgar Ali Ali Mohamad